Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-311

LOUISIANA BANK & TRUST COMPANY
OF CROWLEY, LOUISIANA,
Petitioner,

versus

THE EMPLOYERS LIABILITY ASSURANCE CORP.,
LTD.,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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IN THE
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LOUISIANA BANK & TRUST COMPANY
OF CROWLEY, LOUISIANA,
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THE EMPLOYERS LIABILITY ASSURANCE CORP.,
LTD.,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

The petitioner, LOUISIANA BANK AND TRUST COMPANY of Crowley, Louisiana, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit.

OPINIONS BELOW

The unreported opinion of the United States District Court for the Western District of Louisiana (Lafayette Division) in Civil Action Number 15539, appears at Appendix A, infra, page 1a. The opinion of the United States Court of Appeals, Fifth Circuit, is reported as

case Number 75-1427 in a slip opinion dated June 14, 1976, together with the Court of Appeals decision in *Calcasieu-Marine National Bank of Lake Charles v. American Employers' Insurance Co.*, Number 74-3918, and appears at Appendix B, infra, page 9a. The denial of rehearing by the United States Court of Appeals, Fifth Circuit, appears at Appendix C, infra, page 33a.

JURISDICTION

The decision of the United States Court of Appeals for the Fifth Circuit was announced on June 14, 1976. A petition for rehearing was filed on June 24, 1976. Rehearing was denied on July 12, 1976, as appears from Appendix C, infra, page 33a. The judgment of the Court was entered on July 20, 1976, and appears at Appendix D infra, page 34a. This petition for certiorari is timely filed within the delays provided by 28 U.S.C. §2101. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

1. Whether the holding of the court of Appeals is in conflict with the decisions of the Courts of Appeals for the Seventh and Eighth Circuits in *First National Bank of Decateur v. The Insurance Company of North America*, 424 F.2d 312 (7th Cir. 1970); *Pioneer Valley Savings Bank v. The Indemnity Insurance Company of North America*, 225 F.Supp. 404, aff'd 343 F.2d 634 (8th Cir. 1965); *United States for the Use of First Continental National Bank & Trust Company v. Western Contracting Corporation*, 341 F.2d 383 (8th Cir. 1965); and *Hartford Accident & Indemnity Company v.*

Federal Deposit Insurance Corp., 204 F.2d 933 (8th Cir. 1953), and with the decision in *National Bank of Commerce in New Orleans v. Fidelity and Casualty Company of New York*, 312 F.Supp. 71 (E.D.La. 1970), aff'd 437 F.2d 96 (5th Cir. 1971), cert. den. 403 U.S. 906, 91 S. Ct. 2209 (1971), which allow recovery under Bankers Blanket Bond Form 24 for losses incurred in transactions similar to those held by the Court of Appeals in this case to be excluded from coverage by the "loan exclusion" of that Bond. In this case, the Court of Appeals effectively defined a loan as any money "advanced to a customer of the Bank". Slip opinion at 4059; Appendix B, infra, page 23a. Other Courts of Appeals have held, however, that *not all* advances of money to the Bank's customers are "loans" within the meaning of the "loan exclusion" of the Bond.

2. Whether the holding of the Court of Appeals that the Bank suffered no loss from the deposit of two checks returned for insufficient funds ("NSF checks") is supported by the Court of Appeals' findings of fact, and is based upon a correct interpretation of Louisiana Revised Statutes 7:136-37.

3. Whether penalties and attorney's fees are due the Bank under the provisions of Louisiana Revised Statutes 9:3902 and/or Louisiana Revised Statutes 22:658. (This question was not reached by the Court of Appeals and will be reached only if the decision of the Court of Appeals denying recovery is reversed; it is presented here to preserve the right of the Bank to assert it.)

STATE STATUTES

LOUISIANA REVISED STATUTES 7:126
(repealed by Act 92 of 1974):

§ 126. Bill of exchange defined

A bill of exchange is an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to order or to bearer.

LOUISIANA REVISED STATUTES 7:136
(repealed by Act 92 of 1974):

§ 136. Time allowed for acceptance

The drawee is allowed twenty-four hours after presentment in which to decide whether or not he will accept the bill; but the acceptance if given dates as of the day of presentation.

LOUISIANA REVISED STATUTES 7:137
(repealed by Act 92 of 1974):

§ 137. Acceptance by destruction or failure to return bill

Where a drawee to whom a bill is delivered for acceptance destroys the same, or refuses within twenty-four hours after such delivery, or within such other period as the holder may allow, to return the bill accepted or non-accepted to the holder, he will be deemed to have accepted the same.

LOUISIANA REVISED STATUTES 9:3902:

§ 3902. Failure of surety to pay; recovery of attorney's fees

If the surety on a bond fails to pay his obligation and it becomes necessary for the creditor to sue thereon, the latter shall be entitled to ten per cent attorney's fees on the amount recovered, provided he has employed an attorney for the purpose, has made written amicable demand on the principal and surety and thirty days have elapsed from their receipt thereof without payment being made, and the full amount claimed in the demand is recovered.

This Section shall not affect the right to recover interest and costs as otherwise provided by law.

LOUISIANA REVISED STATUTES 22:658:

§ 658. Payment of claims, policies other than life and health and accident; penalties

All insurers issuing any type of contract other than those specified in R.S. 22:656 and 22:657 shall pay the amount of any claim due any insured including any employee under Chapter 10 of Title 23 of the Revised Statutes of 1950 within sixty days after receipt of satisfactory proofs of loss from the insured, employee or any party in interest. Failure to make such payment within sixty days after receipt of such proofs and demand therefor, when such failure is found to be arbitrary,

capricious, or without probable cause, shall subject the insurer to a penalty, in addition to the amount of the loss, of 12% damages on the total amount of the loss, payable to the insured, or to any of said employees, together with all reasonable attorney's fees for the prosecution and collection of such loss, or in the event a partial payment or tender has been made, 12% of the difference between the amount paid or tendered and the amount found to be due and all reasonable attorney's fees for the prosecution and collection of such amount. Provided, that all losses on policies covering automobiles, trucks, motor propelled vehicles and other property against fire and theft, the amount of the penalty in each of the above cases shall be 25% and all reasonable attorney's fees.

STATEMENT OF THE CASE

This is a suit by Louisiana Bank on the Banker's Blanket Bond issued it by The Employers Liability Assurance Corporation, which insured the Bank against losses sustained through common-law or statutory larceny, theft, or false pretenses. This is a diversity action. 28 U.S.C. §1332.

The Bank sought recovery for its losses in two separate transactions, both of which involved dealings with Lake Rice Mill, Inc., and Rex Rice Company and with the President of both companies, Jack R. Smith.

Connell Drafts

In one of the transactions, the Bank's loss resulted from the non-payment of seven drafts drawn on Connell Rice & Sugar Co., Inc., of Westfield New Jersey.

The drafts, each of which was in the amount of Twenty-two Thousand Eight Hundred Sixty-six and 28/100 Dollars ($22,866.28), were drawn by Rex Rice Company, Inc., and were deposited to the account of Rex Rice Company in Louisiana Bank. Credit was allowed Rex Rice Company for the amount of the deposit immediately, and the funds thereby obtained were withdrawn and disbursed by Rex Rice Company.

Louisiana Bank had engaged in similar transactions involving Connell drafts with Rex Rice over a period of years. Hundreds of such drafts were deposited by Rex Rice Company to its account in Louisiana Bank. In each such case, Rex Rice Company obtained immediate credit for the amount of the draft, and was allowed to draw upon such funds, prior to payment of the draft by Connell Rice & Sugar Co., Inc. None of these transactions were entered on the loan liability ledger of Rex Rice Company Inc., at Louisiana Bank, or on the general loan journal of Louisiana Bank. The Court of Appeals found that "Blank notes bearing Jack Smith's signature as Rex President, but no indication of amount, were taken by the Bank with the Connell drafts." Slip Opinion at 4060; Appendix B, infra, page 24a.

The drafts were forwarded for collection through a correspondent bank, which credited Louisiana Bank's account for the amount of the drafts, and charged Louisiana Bank interest on that amount until payment of the draft was received from Connell. Louisiana Bank charged Rex Rice Company's account for the same sum charged by the correspondent, and made no direct profit on the transaction.

The drafts drawn by Rex Rice Company on Connell Rice & Sugar Co., Inc. over the years, and deposited to Rex Rice Company's account in Louisiana Bank, were the means by which Rex Rice Company obtained payment for shipments of rice to Connell Rice & Sugar Co., Inc. Certain documentation of such shipments was necessary, and was attached to the drafts when forwarded for payment.

At the time of the deposit of the seven drafts from which the loss in this matter resulted, Jack R. Smith represented to Louisiana Bank, as he had many times before, that shipments of rice had been made by Rex Rice Company to Connell Rice & Sugar Co., Inc., and that the drafts were the means of obtaining payment due Rex Rice Company for those shipments. At the time of the initial deposit of the seven drafts, Smith represented that certain documentation of the shipments was missing and would be supplied later. Smith subsequently furnished fictitious documentation, and the drafts were forwarded to Connell Rice & Sugar Co., Inc., which refused to pay. The evidence indicates that there were no shipments by Rex Rice Company to Connell Rice & Sugar Co., Inc. for which payment was due. The District Court found that Jack R. Smith "knowingly misrepresented material facts and supplied fictitious documentation to obtain credit for the drafts." See Appendix A page 6a, infra.

The Court of Appeals reversed the judgment of the District Court granting the Bank recovery for the losses sustained in the Connell draft transaction solely on the ground that the draft transaction was a "loan" and was, therefore not covered by the Banker's Blanket Bond.

NSF Checks

The Bank also seeks to recover for losses sustained as a consequence of the deposit of two checks returned for insufficient funds ("NSF Checks") totaling One Hundred Ten Thousand Five Hundred Nine and 80/100 Dollars ($110,509.80) drawn on Lake Rice Mill's account and deposited to Rex Rice Company's account with Louisiana Bank. Immediately after the deposit of those checks, Jack R. Smith issued a Rex Rice Company check to Louisiana Bank for One Hundred Four Thousand Five Hundred Sixty-six and 84/100 Dollars ($104,566.84), and the Bank used those funds to pay a number of "rough rice drafts" drawn on Rex Rice Company "through" Louisiana Bank, which had been held by Louisiana Bank for over twenty-four hours without acceptance or dishonor.

The Court of Appeals reversed the District Court and denied recovery for the NSF Checks on the ground that Louisiana Bank was liable on the "rough rice drafts" drawn on Rex Rice Company that it had held for more than twenty-four hours, citing Louisiana Revised Statutes 7:136-37 (repealed, effective January 1, 1975, by act 92 of 1974), and that it suffered no damage because those drafts were paid with the funds obtained by the deposit of the NSF Checks.

REASONS FOR GRANTING THE WRIT

1.

The Decision Below Is In Conflict With Decisions Of The Courts Of Appeals For The

Seventh And Eighth Circuits Interpreting The "Loan Exclusion" Of Bankers Blanket Bond Form 24.

Insuring clause (B) of the Bankers Blanket Bond insures against on premises losses caused by, among other things, "common-law or statutory larceny, theft, [or] false pretenses . . .". The Bond excludes coverage, however, for

> "(d) Any loss the result of the complete or partial non-payment of or default upon any loan made by or obtained from the Insured, whether procured in good faith or through trick, artifice, fraud or false pretenses, except when covered by Insuring Clause (A), (D) or (E)."

The Court of Appeals held that the transactions between Louisiana Bank and Rex Rice Company involving drafts drawn on Connell Rice & Sugar Co., Inc., were "loans" within the meaning of that term as used in the exclusionary clause of the Bond quoted above.

In supporting its holding, the Court of Appeals cited a portion of the many cases decided both by the Courts of the State of Louisiana and those of other jurisdictions holding that words in insurance policies are to be construed in their ordinary and popular sense; that exclusions in insurance policies must be clearly expressed; and that ambiguities in policies are to be resolved in favor of the insured.

In reaching its decision that the transactions between Louisiana Bank and Rex Rice Company were

"loans" within the meaning of the Bankers Blanket Bond, however, the Court of Appeals turned not to the decisions of other Courts interpreting the meaning of the loan exclusion of the Bankers Blanket Bond, but instead to cases deciding other issues, observing that "The manner in which credit was advanced by the Banks is strikingly similar to the transactions called 'loans' in *Bellevue State Bank, Bon Homme County Bank, Bank of the Republic,* and *Schramm.*" Slip Opinion at 4059; Appendix B, infra, page 23a. The cases thus cited were *Bellevue State Bank v. Coffin*, 22 Idaho 210, 125 P. 816 (1912); *Bon Homme County Bank v. Dakota National Bank*, 50 S.D. 191, 208 N.W. 825 (1926); *Bank of the Republic v. Baxter*, 31 Vt. 101 (1858); and *Schramm v. Bank of California National Association*, 143 Or. 546, 20 P.2d 1093 (1933).

We respectfully submit that cases decided by other United States Courts of Appeals directly involving the application of the "loan exclusion" of the Bankers Blanket Bond are more relevant than the decisions relied upon by the Court of Appeals in this case. Those cases are *First National Bank of Decateur v. The Insurance Company of North America*, 424 F.2d 312 (7th Cir. 1970); *Pioneer Valley Savings Bank v. The Indemnity Insurance Company of North America*, 225 F.Supp. 404, aff'd 343 F.2d 634 (8th Cir. 1965); *United States for the Use of First Continental National Bank & Trust Company v. Western Contracting Corporation*, 341 F.2d 383 (8th Cir. 1965); and *Hartford Accident & Indemnity Company v. Federal Deposit Insurance Corp.*, 204 F.2d 933 (8th Cir. 1953). Each of these cases deals with a "check-kiting" scheme — that is, a situation in which worthless checks were deposited to an account, immediate credit was given for those checks,

and the funds thus made available were withdrawn before the worthless checks were returned unpaid. In each of these "check-kiting" cases, the insurer raised the defense of the "loan exclusion" of the Bankers Blanket Bond. The insurers argued that the Banks had made "loans" to their customers by permitting them to draw against uncollected items of deposit. In each of the cases cited, the contention of the insurers was rejected, the Courts holding that the mere advance of funds to a customer in such a situation, even though such an advance gave rise to an obligation of repayment, was not a "loan" *within the meaning of that term as used in the Bond.* Those cases distinguish between "check transactions" and "loan transactions" (see *e.g., Pioneer Valley Savings Bank*, 343 F.2d at 653) and hold that such advances of credit are not within the meaning of the term "loan" in ordinary speech or in the Bankers Blanket Bond.

The only case known to counsel involving the applicability of the "loan exclusion" of the Bankers Blanket Bond to losses arising from the granting of immediate credit for drafts drawn upon a third person and subsequently not paid is *National Bank of Paulding v. Fidelity and Casualty Company*, 131 F.Supp. 121 (S.D. Ohio 1954). In the *National Bank of Paulding* case, the arguments of the insurer that the loan exclusion applied were rejected and recovery was allowed.

The opinion of the Court of Appeals in this case implies that *every* advance of funds by a bank to a customer is a "loan" within the meaning of the loan exclusion of the Bankers Blanket Bond. This holding is in conflict with the cases allowing recovery in in-

stances of check-kiting, because each such case involved an advance of funds to a customer of the bank. If there were no such "advance" of funds, no damage would be sustained by a bank in a check-kiting scheme, since the customer would not be allowed to draw against the deposit until the check had cleared and had been collected. Footnote 3 of the Court of Appeals' opinion in this case implies that because the analogy between check-kiting and depositing drafts is "not exact," check-kiting schemes are less like loans than the deposit of drafts in this case. But in check-kiting schemes the bank usually relies solely upon the credit of its customer, that is, it advances him funds upon the expectation that he has available or will make available sufficient funds to "cover" what is usually *his* check, and will thus cause the check to be paid. In the present case, however, Louisiana Bank relied on something more than its estimate of the worth of its customer's credit: it relied upon (mis-) representations that shipments of rice had been made to Connell Rice & Sugar Co., Inc., for which Connell was liable to pay, and for which Connell would pay, as it had so many times before, upon presentation of the drafts.

We respectfully submit that the check-kiting cases cited above are closely analogous to the present case, and that their interpretation of the "loan exclusion" of the Bankers Blanket Bond limiting the scope of that exclusion to formal loans should be applied to the facts of this case, and that the decision of the Court of Appeals should be reversed on that point.

2.

The Decision Below That No Loss Has Been Shown On The NSF Checks Is Not Supported By The Court Of Appeals' Findings Of Fact And Is An Incorrect Interpretation Of Louisiana Revised Statutes 7:136-37.

The Court of Appeals described the NSF Check transaction as follows:

> Louisiana Bank also claims to have lost money by honoring two checks, deposited with it by Jack Smith for the Rex account, that were returned for insufficient funds (NSF) and for which no collection was ever made. Louisiana Bank was, at the time Smith deposited the checks, holding numerous "rough rice drafts" drawn on Rex's account for the benefit of farmers who had sold rice to Rex. These drafts, having been held by the bank for more than twenty-four hours without acceptance or dishonor, were considered "stale". Under Louisiana law at that time, Louisiana Bank would have been liable itself on these drafts if they had been regular on their face. The bank, anxious about the stale drafts, asked Jack Smith to pay for some of them. Smith drew two checks, totalling $110,509.80, on Lake's account with Calcasieu and deposited these into the Rex account with Louisiana Bank. He then wrote a Rex check to Louisiana Bank for $104,566.84, and the bank paid off a similar amount in stale rough rice drafts with its own cashier's check. The Lake checks, sent

> through normal banking lines for collection, were returned NSF.

Slip opinion at 4054; Appendix B, infra, page 12a.

The Court of Appeals then held:

> Although there is no direct evidence that the drafts paid by Louisiana Bank with the proceeds of the NSF checks were regular on their faces, there is overwhelming indirect evidence to that effect. There is no suggestion in the record of any irregularity of such drafts. There is no suggestion that the exemplary draft, Defendant's Exhibit 19, is irregular. There is no reason to believe that Louisiana Bank, when faced with such a huge loss on stale rough rice drafts, would have paid off any drafts on which it was not liable.

Slip opinion at 4063-64; Appendix B, infra, page 31a.

The Court of Appeals' opinion holds that Louisiana Bank suffered no loss through the negotiation of the NSF checks involved in this litigation because the funds disbursed after deposit of those checks went to pay drafts drawn on Rex Rice Company that had been held by Louisiana Bank for more than twenty-four hours. The Court refers to the "breadth of the pretrial stipulation" and holds that it was "imperative for Louisiana Bank . . . to show that it was not liable on such drafts." Slip opinion at 4064; Appendix B, infra, page 32a. We respectfully submit that the reading given the stipulations by the Court exceeds their actual scope. The stipulations relied on are numbers 23, 26, 36 and 37 of the Pretrial Order:

"23. On March 17, 1969 the total amount of stale rough rice drafts on Rex Rice Company held by Louisiana Bank (i.e. drafts which had been held for longer than 24 hours without return or payment) exceeded $104,000.00.

* * *

"26. On the same date, Louisiana Bank & Trust Company paid $100,518.89 of Rex's outstanding stale drafts and shortly thereafter paid an additional $4,037.94 of stale Rex drafts which had been outstanding March 17.

* * *

"36. The Louisiana Bank & Trust Company concedes that its records show that Louisiana Bank & Trust Company failed to accept or to make timely protest or non-acceptance of considerably more than $110,000.00 worth of Rex's rough rice drafts, which for the sake of brevity shall be referred to as "stale drafts", and this made Louisiana Bank & Trust Company liable to the payees for the payment of said drafts.

"37. Louisiana Bank & Trust Company did, in fact, accept or concede liability for at least $512,972.37 of similar stale drafts still remaining unpaid after March 17, 1969."

The term "stale drafts" is defined in *both* stipulations 23 and 26. The definitions are not the same. In 23, it is "drafts which had been held for longer than 24 hours

without return or payment" — a simple statement of fact. In 36, it is drafts "that Louisiana Bank & Trust Company failed to accept or to make timely protest or non-acceptance of" — a conclusion of law. The presumption must be that each definition is limited in its scope to the stipulation in which it occurs.

The stipulations say that Louisiana Bank and Trust Company conceded liability on other drafts of Rex rice (that is, drafts not paid with the proceeds of the deposit on March 17, 1969), and the Court holds that this placed a burden upon Louisiana Bank and Trust Company to show that the drafts paid on March 17, 1969, were different than those on which Louisiana Bank and Trust later conceded liability. The drafts paid on March 17, 1969, are not in evidence. We can offer speculation that the drafts might or might not have been subject to the twenty-four hour rule of the Louisiana Revised Statutes, or that payment might or might not have been demanded from Louisiana Bank and Trust Company by persons holding those drafts, but the important point is that the actions of Rex rice, through its President, Jack Smith, in accepting the drafts on March 17, 1969, and ordering their payment, eliminated any possibility of a determination of Louisiana Bank's liability on those drafts, other than in the present litigation. We respectfully submit that the Court's opinion shifts the burden of proof incorrectly to Louisiana Bank and Trust Company in this matter. The stipulations, as outlined above, are not equivalent to a stipulation of Louisiana Bank's liability on the drafts paid on March 17, 1969, and, we respectfully submit, as a consequence, the fact of Louisiana Bank's liability on those drafts remained a matter of defense.

One final comment is necessary on this matter. The Court observes (slip opinion page 4063) that "there is no reason to believe that Louisiana Bank, when faced with such a huge loss on sale of Rex Rice drafts, would have paid off any drafts on which it was not liable." We respectfully submit that this assertion by the Court does not take into account the fact that the drafts paid on March 17, 1969, were not paid by Louisiana Bank, but were, instead, paid by Rex Rice Company with funds deposited into Rex's account on that date. Through the use of the NSF checks, Rex obtained payment of the drafts. The Court of Appeals, we respectfully submit, is in error to read the payment of the drafts on that date as a concession of liability by Louisiana Bank and Trust Company. At that time, Rex Rice Company was, from Louisiana Bank's point of view, still in control of its affairs, and was still ordering the bank to pay or not to pay such drafts.

CONCLUSION

For these reasons, a writ of certiorari should issue to review the judgment of the United States Court of Appeals for the Fifth Circuit.

By its attorneys,

REGGIE HARRINGTON AND BOSWELL

EDMUND M. REGGIE
P.O. Drawer D
Crowley, Louisiana 70526
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CERTIFICATE

I certify that I have served the foregoing Petition for Certiorari on Mrs. Marian Mayer Berkett and Mr. Charles F. Seeman, Jr., of Deutsch, Kerrigan and Stiles, 4700 One Shell Square, New Orleans, Louisiana, counsel for The Employers Liability Assurance Corp. Ltd. by U.S. Mail, postage prepaid, this ____ day of August, 1976.

EDMUND M. REGGIE

APPENDIX A

United States District Court — Civil Action
Western District of Louisiana — Number 15539
Lafayette Division

LOUISIANA BANK AND TRUST COMPANY

versus

THE EMPLOYERS LIABILITY ASSURANCE CORP., LTD.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Findings of Fact

The above entitled cause came on regularly for trial and the Court having duly considered the evidence and being fully advised in the premises now finds the following:

I.

At all times material to this law suit, Louisiana Bank and Trust Company had in effect a Banker's Blanket Bond in the amount of $200,000.00 issued by the defendant, The Employers Liability Assurance Corp., Ltd., on Banker's Blanket Bond Form 24. Under Paragraph B of that bond,[1] the defendant agreed to compensate the plaintiff for:

---

1 This Section of the "Banker's Blanket Bond" is in reality an insurance provision against losses incurred by the bank by virtue of the criminal activities of third persons, including depositors,

"Any loss of Property through robbery, burglary, common-law or statutory larceny, theft, false pretenses, hold-up, misplacement, mysterious unexplainable disappearance, damage thereto or destruction thereof, whether effected with or without violence or with or without negligence on the part of any of the Employees . . ."

II.

On March 17, 1969, Jack Smith, who was the president of both Rex Rice Company, Inc., and Lake Rice Mill, Inc., deposited two checks (Exhibits P-3 and P-4) signed by him as president of Lake and drawn on the Lake account in Calcasieu-Marine National Bank, Lake Arthur, Louisiana, to the Rex account in Louisiana Bank and Trust Company. One of those checks was in the amount of $55,509.80 and the other was in the amount of $55,000.00. Both of the checks were subsequently returned by the banks upon which they were drawn because there were insufficient funds to pay them. Neither check has ever been paid.

III.

After the checks were deposited to the account of Rex Rice Company, Inc., Louisiana Bank and Trust Company granted Rex Rice immediate credit and disbursed the funds obtained by the deposit of the two

enumerated therein. One Louisiana case, *Victory Electric Works, Inc. v. Maryland Casualty Co.*, 230 So. 2d 287 (La. App. 1970), has held in dicta that paragraph B of the bond falls under LSA-R.S. 22:6(8) and renders the underwriter surety of the person perpetrating the fraud, robbery, etc. The issue has not been adjudicated by the Louisiana Supreme Court, and it is not necessary for our decision here.

checks at the direction of Jack Smith, thereby incurring a loss of $110,509.80.

IV.

On March 17, 1969, the account of Lake Rice Mill, Inc., upon which the checks totaling $110,509.80 were drawn had a balance of $1,758.30.

V.

On March 19, 1969, Jack Smith deposited a check (Exhibit P-7) signed by him as president of Rex and drawn on the account of Rex Rice Company, Inc., St. Landry Bank and Trust Company, Eunice, Louisiana, to the account of Rex in Louisiana Bank and Trust Company. That check was in the amount of $2,000.00, and was not paid by the bank upon which it was drawn because there were insufficient funds in the account to cover it.

VI.

The check for $2,000.00 has never been paid, and the immediate grant of credit made by Louisiana Bank and Trust Company after receipt of the deposit of that check caused it to incur a loss of $2,000.00.

VII.

Because of the vast discrepancy between the amounts actually on deposit and the face amounts of the checks, and, because of Jack Smith's status as president of both corporations involved in this matter,

the court finds that Smith knew that the funds on hand were insufficient to satisfy the checks.

VIII.

During the period from 1961 until 1969, Rex Rice Company, Inc. made approximately 720 shipments of rice to Connell Rice & Sugar Company, Inc., Westfield, New Jersey. Payments for these shipments were effected by sight drafts drawn on Connell by Rex, and forwarded with documentation of the shipment for which payment was sought.

IX.

During that period, it was customary for Rex to deposit such drafts to its account in Louisiana Bank and Trust Company and to receive credit for them while they were in process of collection.

X.

Late in February or early in March of 1969, seven drafts drawn by Rex on Connell, each in the amount of $22,866.28 (Exhibits P-9/P-15) were deposited by Jack Smith to the account of Rex Rice in Louisiana Bank, and credited immediately to that account.

XI.

At the time the deposits were made, Jack Smith represented to the bank that certain documentation of rice shipments necessary to effect payment of the drafts was not then attached to them but that the additional documents would be supplied by him.

XII.

Subsequently, Smith supplied what he represented to be the required documentation for payment and the drafts were forwarded to Connell Rice & Sugar Company, Inc. for payment.

XIII.

Connell Rice & Sugar subsequently refused to pay the drafts, and Louisiana Bank and Trust Company suffered a loss of $160,063.96 as a result of having allowed Rex Rice Company to withdraw and disburse the funds obtained by the deposit of those drafts.

XIV.

The documents supplied by Jack Smith to the bank were, contrary to his representations, insufficient to obtain payment of the drafts, and did not document shipments of rice actually made to Connell by Rex.

XV.

Some of the documentation consisted of copies of documents representing shipments that had been paid for under other drafts drawn on Connell by Rex and paid by Connell before the drafts at issue in this suit were received by Connell.

XVI.

Because of the ficticious nature of the documentation presented to Louisiana Bank by Jack Smith, and

because of Smith's position as president and chief executive officer of Rex, and his consequent knowledge of the affairs of Rex and of what was required in its dealings with Connell, the court finds that Smith knowingly misrepresented material facts and supplied ficticious documentation to obtain credit for the drafts.

XVII.

The Connell draft transactions appeared in the records of Louisiana Bank as deposits to the account of Rex Rice Company, Inc.

XVIII.

No entry was made on the loan liability ledger of Rex Rice Company, Inc., or on the general loan journal of Louisiana Bank, in connection with the Connell draft transactions.

XIX.

Before suit was filed in this matter, the defendant made a payment of $7,942.96 to the plaintiff, which was accepted and retained by the plaintiff.

Conclusions of Law

From the foregoing facts, the Court concludes:

I.

By presenting the three NSF checks to Louisiana Bank and Trust Company, Jack Smith represented (in

his double capacity as president of both Rex and Lake) that sufficient funds were on hand in the accounts upon which the checks were drawn to pay those checks. In light of the vast discrepancy between the amounts actually on deposit in those accounts, and the face amounts of the checks, and, considering Jack Smith's status as president of both corporations involved in this matter, the conclusion is inescapable that Smith knew that the funds on hand were insufficient to satisfy the checks. His representation to the bank was, therefore, knowingly false, and constituted "false pretenses" within the meaning of that phrase as used in Paragraph B of the Banker's Blanket Bond Form 24. It is beyond dispute under Louisiana law that losses resulting from the knowing issuance of worthless checks are covered by Paragraph B of the Banker's Blanket Bond Form 24. See *National Bank of Commerce in New Orleans v. Fidelity Casualty Company of New York*, 312 F. Supp. 71 (E.D. La. 1970), aff'd 437 F. 2d 96 (5th Cir. 1971), *cert. den.* 403 U.S. 906, 91 S. Ct. 2209 (1971).

II.

The misrepresentations made to Louisiana Bank by Jack Smith with reference to the Connell drafts, and the ficticious documentation supplied by Smith to the bank, constituted "false pretenses" within the meaning of that term as used in Paragraph B of the Banker's Blanket Bond Form 24. The transactions between Rex and Louisiana Bank involving the Connell drafts were not "loans" within the meaning of that term as used in the Banker's Blanket Bond. There was no meeting of the minds of the parties in a loan transaction. Smith

represented that the sight drafts were a means of obtaining payment of valid obligations of Connell. Louisiana Bank expected those obligations to be paid in a normal course of events as they had been in the past. The facts in this case are very similar to those set forth in *National Bank of Paulding v. Fidelity and Casualty Company*, 131 F. Supp. 121 (S.D. Ohio 1954). In that case, ficticious documentation was also presented with sight drafts for the purpose of obtaining immediate credit for those drafts. Such practices were held to be within the coverage afforded by Paragraph B of the Banker's Blanket Bond Form 24. It is clear in this case, as it was in *National Bank of Paulding*, that the minds of the parties had not met in a loan transaction, and that the loan exclusion of the Banker's Blanket Bond does not apply to the situation at hand.[2]

III.

Louisiana Bank and Trust Company has proven damages of $272,573.76, representing the total amount obtained from the plaintiff bank in the NSF check and Connell draft transactions. The bond sued upon is, however, limited in amount to $200,000.00. In addition, defendants have made a payment to plaintiff of $7,942.96 before suit in this matter, and are entitled to credit for that payment.

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2 Calcasieu Marine National Bank v. American Employers Insurance Co., No. 15,534, Western District of Louisiana, decided September 19, 1974 by Judge Scott, not yet reported, deals with similar transactions between Smith, Rex Rice Mill and Lake Rice Mill, and the Calcasieu Marine Bank. We agree with Judge Scott that the losses sustained were covered by Paragraph B as thefts under the Louisiana Criminal Code.

IV.

The plaintiff is entitled to judgment in the amount of $192,057.04, and for its costs and disbursements herein expended.

Let judgment be rendered accordingly.

Dated this 15th day of January, 1975.

/s/ R. J. PUTNAM
UNITED STATES DISTRICT JUDGE

APPENDIX B

CALCASIEU-MARINE NATIONAL BANK OF LAKE CHARLES,
Plaintiff-Appellee,

v.

AMERICAN EMPLOYERS' INSURANCE CO.,
Defendant-Appellant.

LOUISIANA BANK & TRUST CO.,
Plaintiff-Appellee Cross Appellant,

v.

The EMPLOYERS LIABILITY ASSURANCE CORP.,
Defendant-Appellant Cross Appellee.

Nos. 74-3918, 75-1427.

United States Court of Appeals,
Fifth Circuit.

June 14, 1976.

Appeals from the United States District Court for the Western District of Louisiana.

Before WISDOM, COLEMAN and GEE, Circuit Judges.

WISDOM, Circuit Judge:

Before us are two diversity cases in which the critical legal question is substantially the same. American Employers' Insurance Company appeals from a judgment, on a bankers blanket bond, in favor of the Calcasieu-Marine National Bank (Calcasieu). The Employers' Liability Assurance Corporation, Ltd., appeals from a judgment, on a similar bond, in favor of the Louisiana Bank and Trust Company of Crowley, Louisiana (Louisiana Bank). In view of this Court's disposition of the two appeals, only one opinion is necessary.

Each bank claimed that losses incurred by it, with respect to various transactions culminating in the bankruptcy of a bank customer, were covered by the respective bonds. The defendants denied liability on numerous grounds. We reverse the district court judgments for the plaintiffs. First, we hold that the losses sustained by Calcasieu and by Louisiana Bank fell within a bond provision that excluded coverage for losses due to bank loans. Second, we hold that the remainder of the alleged loss suffered by Louisiana Bank was not a loss at all.

I

FACTS

Both cases arise out of the transactions of the banks with two rice mills and with Jack R. Smith, the president of both mills. The Lake Rice Mill, Inc., (Lake) and the Rex Rice Co. (Rex) were in the business of purchasing "rough" rice from farmers, milling and cleaning the rice, packaging the rice in varying quantities, and selling the rice to food companies.

The Calcasieu/Lake transaction began when Lake deposited with Calcasieu a draft on the Grace-Kennedy Company (Grace-Kennedy), a Canadian purchaser of rice, for $63,300. Calcasieu, according to its custom, immediately credited Lake for the amount of the draft and forwarded the draft to its correspondent bank in New York for collection. This draft was not honored by Grace-Kennedy for a number of reasons: some of the rice had been damaged and some, apparently, had never been shipped. Instead of honoring the draft, Grace-Kennedy drew a check in the amount of $40,594.40, the adjusted purchase price, to the order of Rex and sent this check to Rex. The check was deposited in Rex's account at Louisiana Bank on February 10, 1969.

Meanwhile, however, another draft on Grace-Kennedy was prepared by Lake and was supported by a Rex invoice.[1] This draft also reflected the adjusted

1 Because Jack Smith operated both rice mills, it was not considered unusual for a draft to be deposited for Lake's account, but supported by a Rex invoice. Jack Smith's dual role explains why Grace-Kennedy sent its check to Rex rather than to Lake.

purchase price of $40,594.40 and, on February 6, 1969, was deposited, as the first draft had been, with Calcasieu for collection. Because money due on the same transaction had already been advanced, Calcasieu adjusted Lake's bank balance to reflect the lower purchase price; it continued to credit Lake with $40,594.40, minus a "service charge" that amounted to interest on its previous advance. Of course, when Grace-Kennedy was presented with the second draft, it did not pay that draft because it had already paid Rex for the same rice directly by check. Calcasieu was notified of the dishonor of the second draft after one and one-half months had elapsed and both rice mills had been closed. Calcasieu's claim arises from the loss on this second draft.

The events which led to Louisiana Bank's claim against its bondsman occurred closer to the demise of the two mills. Louisiana Bank had given Rex credit on seven drafts drawn by Rex on Connell Rice and Sugar Co. (Connell) to cover the purchase of rice sold to Connell. These drafts were not accepted by Connell because the attached documentation was either incomplete or incorrect. Again, by the time the bank became aware of the dishonor, Rex had collapsed.

Louisiana Bank also claims to have lost money by honoring two checks, deposited with it by Jack Smith for the Rex account, that were returned for insufficient funds (NSF) and for which no collection was ever made. Louisiana Bank was, at the time Smith deposited the checks, holding numerous "rough rice drafts" drawn on Rex's account for the benefit of farmers who had sold rice to Rex. These drafts, having been held by

the bank for more than twenty-four hours without acceptance or dishonor, were considered "stale". Under Louisiana law at that time, Louisiana Bank would have been liable itself on these drafts if they had been regular on their face.[2] The bank, anxious about the stale drafts, asked Jack Smith to pay for some of them. Smith drew two checks, totalling $110,509.80, on Lake's account with Calcasieu and deposited these into the Rex account with Louisiana Bank. He then wrote a Rex check to Louisiana Bank for $104,566.84, and the bank paid off a similar amount in stale rough rice drafts with its own cashier's check. The Lake checks, sent through normal banking lines for collection, were returned NSF.

II

THE LOAN EXCLUSION

The bonds contained the following exclusionary provision.

THIS BOND DOES NOT COVER:

. . . . .

(d) any loss the result of the complete or partial nonpayment of or default upon any loan made by or obtained from the Insured, whether procured in good faith or through trick, artifice, fraud or false pretenses, ...

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2 La.R.S. 7:136-37, *repealed*, eff. Jan. 1, 1975 by Act 92 of 1974.

With respect to the Grace-Kennedy drafts and the Connell drafts, the bondsmen contend that the extensions of credit to the rice mill accounts, pending collection of those drafts, constituted a "loan" for the purposes of the bond exclusion. The banks argue that there was no loan; rather, they argue that the transactions were merely advances of credit pending the collection of various items in the normal course of business and that such advances, not commonly referred to in banking terms as loans, cannot be deemed included in the bond exclusion.

This is, as far as we can determine, a question of first impression in the federal courts of appeals. The analysis begins with a review of prior cases considering related problems.

The closest case on the facts is *National Bank of Paulding v. Fidelity and Casualty Co.*, S.D.Ohio 1954, 131 F.Supp. 121. Stoller, who bought, sold, and warehoused seeds and grain, was in the practice of drawing sight drafts on his purchasers. His bank would, upon receipt of the draft, an invoice to the customer, and a bill of lading, credit Stoller's account with the amount of the draft and forward the papers for collection. While the draft was being collected, the bank would charge Stoller's account with interest. The bank lost money when it advanced credit on drafts supported by fictitious accompanying documents. The defendant bondsman tried to relieve itself from liability by reference to the same bond exclusion as is involved here. The district court held that the transaction was not a loan. A loan was described as "a contract [for which] there must be a meeting of the minds". There was no meeting of the minds because "[t]he plaintiff bank expected a return of its money in the same manner that it had received it in the previous transactions". The district courts in *Calcasieu* and *Louisiana Bank* relied on *Paulding* in finding that the instant transactions did not amount to a loan. *See, e. g.*, 388 F.Supp. at 468.

The bonding companies argue that *Maryland Casualty Co. v. State Bank and Trust Co.*, 5 Cir. 1970, 425 F.2d 979, has modified, in this circuit, the availability of the *Paulding*-based argument. In *Maryland Casualty*, Behring negotiated a loan with the bank; the loan was secured by valueless warehouse receipts. The district court held the loan exclusion clause inapplicable, because "Behring knew . . . not only that the warehouse receipts were valueless but also that he never intended to repay the money. He wanted to steal the money, not to obtain a loan, and he simply used the mechanics of the loan procedure to effect the theft". 425 F.2d at 981. We reversed, observing nothing of "the slightest persuasiveness that the exclusionary clause of the bond can be nullified by the subjective fraudulent intent of the borrower, notwithstanding that the objective indicia all point one way — that a loan was made by the Bank to the partnership". *Id.* It is possible to read the two district court opinions here as having fallen into the same mistake as the district court in *Maryland Casualty;* that is, the district courts may have relied upon that part of *Paulding* in which the court focused on Stoller's obviously fraudulent intent. The *Paulding* court had emphasized that "the elements of the transactions which constitute . . . false pretenses . . . . There were no elements of loans in these transactions". This observation was quoted in *Calcasieu*, and the *Louisiana Bank* court approved of *Calcasieu's* reading of *Paulding*.

Finally, we note *National Bank of Commerce in New Orleans v. Fidelity and Casualty Co.*, E.D.La.1970, 312 F.Supp. 71. There, the bank was victimized by a check-kiting scheme.[3] The district court rejected the bonding company's argument that the loan exclusion applied.[4] It stated that "[t]he policy exclusion contemplates a lending transaction knowingly entered into by the bank in reliance on the customer's express agreement to repay, most often for the purpose of making a profit on the interest". The court also relied on *Paulding's* observation that "there must be a meeting of minds". *Id.* at 75. *Maryland Casualty* had not yet been decided. The decision in *National Bank of Commerce* was affirmed, per curiam, by this Court. 437 F.2d 96. The banks here rely heavily on an analogy between check-kiting cases and the instant cases. Although the analogy is strong, we find it unpersuasive. Before delineating our reasons, however, we refer to general principles of insurance law.

3 A check-kiting scheme, of course, is a process whereby a person with a checking account in two banks can create an illusion of money in his accounts. A check drawn on the first bank is deposited with the second bank. Before the check reaches the first bank for payment, a check drawn on the second bank is deposited in the first bank. If the bank is willing to give credit in the interim, and many banks are if the person is a regular customer, the person can use the bank's money without first providing collateral and without paying interest. The scheme can go on as long as the person keeps on depositing checks in both banks and as long as the banks believe that there is money behind the checks.

The analogy between check-kiting and depositing drafts on rice not yet delivered is not exact. In the check-kiting scheme, the depositor usually attempts to keep the kite flying by depositing worthless checks in both banks. In the draft situation, the scheme can continue only so long as the purchaser receives evidence of delivery of the commodity before he must accept or dishonor the draft. The depositor can use the bank's money for a limited period of time; he cannot convince the purchaser to accept the draft by depositing with it a draft drawn on the bank.

4 *See also Pioneer Valley Savs. Bank v. Indemnity Ins. Co.*, N.D.Iowa 1964, 225 F.Supp. 404, 410-12, *aff'd*, 8 Cir. 1965, 343 F.2d 634, 652; *United States v. Western Contracting Corp.*, 8 Cir. 1965, 341 F.2d 383, 390; *Fidelity & Cas. Co. v. Bank of Altenberg*, 8 Cir. 1954, 216 F.2d 294, 304; *Hartford Accident & Indem. Co. v. FDIC*, 8 Cir. 1953, 204 F.2d 933, 937. These cases, like *National Bank of Commerce*, hold that the loan exclusion clause does not apply to losses caused by check-kiting schemes. Not every court that has faced the question, however, has held that the loan exclusion does not apply to a loss resulting from a check-kite. *See Citizens Nat'l Bank v. Travelers Indem. Co.*, M.D.Fla.1967, 296 F.Supp. 300.

First, we observe that this is a diversity action; Louisiana law applies. *Birmingham Fire Insurance Co. v. Adolph*, 5 Cir. 1967, 379 F.2d 948, 951.[5] Although we rely on Louisiana cases, cases from other jurisdictions will be relevant because "[t]he law of insurance is the same in Louisiana as in other states". *Brown v. Life and Casualty Insurance Co.*, La.App.1933, 146 So. 332, 334; *Jernigan v. Allstate Insurance Co.*, 5 Cir. 1959, 269 F.2d 353, 355.

An insurance policy is a contract, and the rules established for the interpretation of agreements are applicable to such policies. *See Theye Y Ajuria v. Pan American Life Insurance Co.*, 1964, 245 La. 755, 161 So.2d 70, *cert. denied*, 377 U.S. 997, 84 S.Ct. 1922, 12 L.Ed.2d 1046; *Wiley v. Louisiana and Southern Life Insurance Co.*, La.App.1974, 302 So.2d 704, *writ denied*, 305 So.2d 540, 541; *Latino v. Hardware Mutual Casualty Co.*, 5 Cir. 1969, 413 F.2d 1043.

The banks' position is arguably fortified by special rules applicable to insurance policies. It is commonly

5 Under *Klaxon Co. v. Stentor Electric Mfg. Co.*, 1941, 313 U.S. 487, 61 S.Ct. 1020, 85 L.Ed. 1477, a federal court must, of course, apply the conflicts rules of the state in which the court sits. LSA-R.C.C. Art. 10 provides that the law of the place where the insurance policy is delivered must govern. *Harmon v. Lumbermens Mutual Ins. Co.*, La. App. 1964, 164 So.2d 397; *David v. Insurance Co. of North America*, E.D.La.1967, 268 F.Supp. 496, 499. Similarly, Louisiana law applies if the bond is construed as a surety agreement, *Lachman v. Block*, 1894, 47 La.Ann. 505, 17 So. 153.

said, for example, that exclusions in insurance policies must be clearly expressed. *See Snell v. Stein*, 1972, 261 La. 358, 259 So.2d 876, 878-79; *Kendrick v. Mason*, 1958, 234 La. 271, 99 So.2d 108, 116; *Birmingham Fire Insurance Co. v. Adolph*, *supra*, at 952. The insurer has the burden of proving an exclusion. *See Standard Life Insurance Co. v. Hughes*, 5 Cir. 1957, 240 F.2d 859, 861-62; *Sparkman v. Highway Insurance Co.*, E.D.La.1967, 266 F.Supp. 197, 203. Another general principle of insurance law is that ambiguities in a policy are to be resolved in favor of the insured. *See, e. g., Albritton v. Fireman's Fund Insurance Co.*, 1954, 224 La. 522, 70 So.2d 111, 113; *Thompson v. Phenix Insurance Co.*, 1890, 136 U.S. 287, 297, 10 S.Ct. 1019, 34 L.Ed. 408; *Godfrey v. United States Casualty Co.*, W.D.La. 1959, 167 F.Supp. 783, 790. This principle has been stated at times to require a finding for the insured where the insured's interpretation of the policy is "reasonable", notwithstanding other reasonable interpretations favoring the insurer. *See Zoller v. State Board of Education*, La.App.1973, 278 So.2d 868, 870.[6]

6 One commonly expressed rationale for this rule is that it would be unjust to construe an ambiguous provision in favor of the party that drafted it. *See, e. g., First National Bank v. Hartford Fire Insurance Co.*, 1878, 95 U.S. 673, 678, 24 L.Ed. 563, 565. This rationale may not be applicable here, in view of the fact that the bankers' blanket bond being construed was drafted by a joint effort of the American Bankers' Association and the American Surety Association. All parties are, apparently, members of these respective associations, and it would appear, therefore, that each party was equally responsible for the policy language. This is an additional factor supporting the result we reach in this appeal. *See Community Federal Savs. & Loan Ass'n v. General Cas. Co.*, 8 Cir. 1960, 274 F.2d 620, 625, which held that the bond could not be construed to allow coverage for losses resulting from a loan procured by fraud. *Community Federal* was substantially relied upon in *Maryland Cas. Co. v. State Bank & Trust Co.*, 5 Cir. 1970, 425 F.2d 979, 981-82.

Finally, the banks might rely on the principle of insurance law that words are to be construed in their plain, ordinary, and popular sense. *See Muse v. Metropolitan Life Insurance Co.*, 1939, 193 La. 605, 192 So. 72, 75; *Floyd v. Pilot Life Insurance Co.*, La.App.1961, 135 So.2d 546, 548; *Bergholm v. Peoria Life Insurance Co.*, 1932, 284 U.S. 489, 492, 52 S.Ct. 230, 76 L.Ed. 416; LSA-R.C.C. Art. 1946.[7] This rule is varied from only if a word is used as a "term of art", in which case its meaning in the area for which it is a term of art is applied. *See* LSA-C.C. Art. 1947[8]; *Reliance Insurance Co. v. Orleans Parish School Board*, 5 Cir. 1963, 322 F.2d 803, 806, *cert. denied*, 377 U.S. 916, 84 S.Ct. 1180, 12 L.Ed.2d 186.

In support of the nonapplicability of the loan exclusion clause, it would be argued first that the word "loan", as used in the clause, is ambiguous. The banks would obviously contend that the exclusion refers to a situation in which the lender comes into the bank, negotiates with the loan department, signs a promissory note, and receives from the bank money which must be repaid at interest. We refer to such a transaction as a formal loan. The bonding companies, on the other hand, would argue that "loan", as used in the policy, refers to a transaction in which the bank lends money to a borrower; such a loan may take many

7 This article provides:

> The words of a contract are to be understood, like those of a law, in the common and usual signification, without attending so much to grammatical rules, as to general and popular use.

8 This article provides:

> Terms of art or technical phrases are to be interpreted according to their received meaning with those who profess the art or profession to which they belong.

forms, only one of which is a formal loan. We refer to this type of transaction as a de facto loan. The banks would then argue that, since the policy does not specify formal loans or de facto loans, the word "loan" is ambiguous and the ambiguity must be construed in the banks' favor. Supporting this position, the banks would argue that the insurer has not clearly expressed its intention to deny coverage to de facto loans, that the insurer has not overcome its burden of proving the exclusion, that the word "loan" means, in the ordinary and popular sense, a formal loan, and that, if the word is to be interpreted as a term of art, it still refers only to a formal loan.

The bonding companies would rejoin that the special rules favoring the insured are only applicable when there *is* an ambiguity. They would argue that the word "loan" is not ambiguous but is intentionally broad, that the contract refers to "any loan", and that the exclusion covers all circumstances in which there has been a de facto loan.

The special rules of interpretation do indeed apply only when there is an ambiguity; courts ought not to strain to find such ambiguities, if, in so doing, they defeat probable intentions of the parties. *See Monteleone v. American Empire Insurance Co.*, 1960, 239 La. 773, 120 So.2d 70, 72.[9] This is so even when the result is an apparently harsh consequence to the in-

9 *See also Hemel v. State Farm Mut. Auto. Ins. Co.*, 1947, 211 La. 95, 29 So.2d 483, 485; *Jennings v. Louisiana & Southern Life Ins. Co.*, La.App. 1973, 280 So.2d 297, 300; *Clerk v. Connecticut Fire Ins. Co.*, La.App. 1967, 203 So.2d 866, 868, *writ ref.*, 251 La. 733, 206 So.2d 90; *Bowab v. St. Paul Fire and Marine Ins. Co.*, La.App.1963, 152 So.2d 66, 68, *app. denied*, 244 La. 664, 153 So.2d 881; *Green v. National Bellas Hess Life Ins. Co.*, La.App. 1960, 124 So.2d 397, 398.

sured. *See State Bank of Poplar Bluff v. Maryland Casualty Co.*, 8 Cir. 1961, 289 F.2d 544, 547; *American Casualty Co. v. Myrick*, 5 Cir. 1962, 304 F.2d 179 (by implication).

General principles do not always decide particular cases. With that in mind, we attempt to understand the meaning of the term "loan" as used in the policy exclusion. First, we illustrate some of the many situations in which there exists a de facto loan and show that the instant transactions fall into that category.

The classic definition of a loan is given in *In re Grand Union Co.*, 2 Cir. 1914, 219 F. 353, 356.

> A loan of money is a contract by which one delivers a sum of money to another and the latter agrees to return at a future time a sum equivalent to that which he borrows.
>
> "In order to constitute a loan there must be a contract whereby, in substance one party transfers to the other a sum of money which that other agrees to repay absolutely, together with such additional sums as may be agreed upon for its use. *If such be the intent of the parties, the transaction will be considered a loan without regard to its form.*" (Emphasis added.)

This language is used as the definition of a loan in *The Michie Co.*, 6 Banks and Banking, ch. 11, § 1 (1952). G. Munn, Encyclopedia of Banking and Finance (F. Garcia, 6th ed. 1962) defines a loan as "The letting out or renting of sums of money by a lender to a borrower, to be repaid with or without interest". *Id.* at 421.

Repeatedly, it has been observed that a loan may exist regardless of the form of a transaction. C. Sollman, Banks and Banking § 4823 (1936); *Williams Deacon and Co. v. Jones*, 1884, 77 Ala. 294, 305-06 (by implication). Loans have been found to exist in transactions that were arguably purchases, *see In re Grand Union, supra; Bon Homme County Bank v. Dakota National Bank*, 1926, 50 S.D. 191, 208 N.W. 825, 826, and in transactions that were arguably transfers in trust, *see Bellevue State Bank v. Coffin*, 1912, 22 Idaho 210, 125 P. 816, 818. Loans have been found, for the purpose of usury laws, when a bank advances money and the transaction is "in substance" a loan. *See Hudson v. Repton State Bank*, 1917, 16 Ala.App. 101, 75 So. 695, 696. Loans, in substance, have been found when the issue is relevant to whether a corporation's actions have been ultra vires, *see Watson v. Jackson*, Tex. Civ.App. 1924, 264 S.W. 603, 610, *error dismissed*, 268 U.S. 681, 45 S.Ct. 637, 69 L.Ed. 1154; *Schramm v. Bank of California National Association*, 1933, 143 Or. 546, 20 P.2d 1093, 1096, and when the issue is relevant to the duty of fair dealing of one who receives money, *see Bank of the Republic v. Baxter*, 1858, 31 Vt. 101, 107. Overdrafts from demand deposit accounts have been thought to constitute loans. *See Schramm, supra*; G. Munn, *supra*, at 563; cf. *Bromberg v. Bank of American National Trust and Savings Association*, 1943, 58 Cal.App.2d 1, 135 P.2d 689, 692; *Prowinsky v. Second National Bank*, 1920, 49 U.S.App. D.C. 363, 265 F. 1003; *Florida-Patsand Corp. v. Central Bank and Trust Co.*, Fla.App.1965, 177 So.2d 533, 534.

These cases support the proposition, with which we agree, that "whether or not [a] transaction constitutes

a loan, is to be determined from the surrounding facts in the particular case". *The Michie Co.*, 6 Banks and Banking, ch. 11, § 4, at 225; *Stolze v. Bank of Minnesota*, 1897, 67 Minn. 172, 69 N.W. 813, 814. We return now to the facts of the case before us.

In both cases, money was advanced to a customer of the bank. The manner in which credit was advanced by the banks is strikingly similar to the transactions called "loans" in *Bellevue State Bank*, *Bon Homme County Bank*, *Bank of the Republic*, and *Schramm*. Moreover, interest was to be charged in both cases. That the presence or absence of interest is significant was noted by Judge Rubin in *National Bank of Commerce*, 312 F.Supp. at 75, and, of course, appeals to common sense.[10]

In the Calcasieu transaction, the only piece of evidence that suggests there was not a loan is the absence of a promissory note. While a note would certainly be evidence of a loan, it is not a prerequisite for the transaction to be a loan. *See, e. g., Merchants' National Bank v. First National Bank*, 8 Cir. 1916, 238 F. 502, 507; *Zurich General Accident and Liability In-*

10 In *Birmingham Fire Ins. Co. v. Adolph, supra*, we were called upon to determine the meaning of the word "employees" for the purposes of an insurance policy exclusion that denied coverage to an employee injured by another employee of the insured partnership. We held that a partner was not an employee within the meaning of the policy exclusion. In so holding, we observed that a relevant consideration would be "whether the partner received wages or other specific compensation in addition to his partnership share of profits". 379 F.2d at 951. One factor supporting our decision was the fact the the $250 per month drawn by the partner involved in the accident depended upon the existence of profits to pay that amount. This made the partner look more like an owner and less like an employee. *Birmingham Fire* supports the notion that common sense is an appropriate method by which to judge whether a transaction falls within an insurance policy exclusion.

surance Co. v. Safe-T-Kros Drug Co., 1930, 91 Ind.App. 130, 170 N.E. 351, 353; *In re Nellis' Will*, Sur.Ct.1926, 126 Misc. 638, 214 N.Y.S. 378, 379. There is no distinction of substance between the Grace-Kennedy transaction and many previous transactions at the bank in which a note was signed.[11] With respect to these latter transactions, Calcasieu originally sued the bonding company and the applicability of the loan exclusion clause was conceded; the only remaining question was whether the transaction fell within an exception to the exclusion. The record does not explain why the Grace-Kennedy draft was not taken with a note as other drafts were. Whatever the reason, however, the absence of a note was clearly not intended to change the substance of the underlying transaction.

With respect to Louisiana Bank, the transaction looks even more like a loan. Credit was advanced on documents which were not even completed. Moreover, the bank's custom was to take a note along with the draft. The bank president, Ogeron, testified that the Federal Deposit Insurance Corporation recommended taking a note with the drafts.[12] Blank notes bearing Jack Smith's signature as Rex president, but no indication of amount, were taken by the bank with the Connell drafts.

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11 We note that Jack Smith, in his deposition, testified that when he'd present a draft to the bank, he'd "sign a note", secured by the invoice. The sight drafts were used as a method of financing in conjunction with promissory notes. Smith believed that the Grace-Kennedy draft would have had to have been presented with a promissory note.

12 The purpose of taking notes was probably to protect the bank from certain kinds of loss. Without a note, it might appear that the bank had purchased the sight drafts and the accompanying documents and fully accepted the risk of dishonor.

Louisiana Bank points out that, although it charged a fee referred to as "interest", that fee was charged to the bank by the American Bank of Baton Rouge (American), and Louisiana Bank was only passing along that charge. American was involved in the transaction, according to Ogeron's testimony, because the Louisiana Bank did not have sufficient *loan capacity* to advance the appropriate credit to Rex. Because of Louisiana Bank's arrangement with American, however, Louisiana Bank obviously continued to bear the risk of loss. At any rate, that Louisiana Bank made no direct profit from the "service charge" it assessed Rex is not important. Banks often borrow money at one rate and lend it at a higher rate. They profit on such transactions but clearly not as much as the rate at which they loan might suggest. Here, the rate of borrowing and the rate of lending is the same. No immediate profit is obvious. The materiality of this is negligible. If it is necessary to find that Louisiana Bank profited from its transaction, the "profit" was derived from its nurturing of Rex's business. Here, Louisiana Bank nurtured Rex's business too long and too hard.

We have shown that the transactions were de facto loans. The final question, then, is whether the policy can be construed to exclude coverage only with respect to formal loans.

In *Travelers Insurance Co. v. Brown*, 5 Cir. 1964, 338 F.2d 229, 237, we observed that, for the purposes of interpreting an insurance contract, the intentions of the parties were paramount. It appears, however, that the parties intended the loan exclusion clause to apply to

different things. The bondsmen's intentions were obviously reasonable. The question, then, is whether the banks' expectations of coverage at the time of the agreement were objectively reasonable. *See* R. Keeton, Insurance Law 351 (1971). We hold that, if the banks expected coverage in this type of transaction, such expectations were not objectively reasonable. First, we repeat that the term "any loan" is broad and is not restricted by any narrowing modifier. The banks should have been aware of the breadth of this term.[13] More importantly, however, the banks are asking, in this instance, for credit insurance: insurance provided against losses from bad debts arising from the sale of goods on credit, coverage for uncollectable accounts. G. Munn, *supra*, at 170. The banks "sold" its goods in trade, money, to its respective customers, Lake and Rex, with the expectation that the purchase price, with interest, would be repaid in the future.[14] The banks lost

13 We reject the argument that there cannot be a loan unless the bank intends to make a "loan". The policy excludes coverage for "any loan *made by or obtained from* the Insured". (Emphasis added.) The words "or obtained from" are especially significant, for they demonstrate that the exclusion applies to situations in which the intent of the lender is not clear. The contract, of course, must be construed, if possible, so as to give effect to all of its stipulations. *See* LSA-C.C. Art. 1955; *Noel Estate, Inc. v. Kansas City S. & G. Ry.*, 1937, 187 La. 717, 175 So. 468, 470; *Solomon v. Hickman*, La.App.1969, 219 So.2d 330, 333. We also reject the statement in *National Bank of Commerce*, 312 F.Supp. at 75, that "loan" in the exclusion clause refers to a transaction in which the borrower has made an express agreement to repay. As we demonstrate in text, that construction unreasonably narrows a broad provision.

14 The banks had, perhaps, no more reason to fear nonpayment with respect to the drafts on which they lost money than they had with respect to the many previous drafts that were honored by the purchasers. Under the *Paulding* reasoning, this alone would take the transaction out of the "loan" category. This reasoning, of course, begs the question. All of the previous transactions could have been, and in fact were, loans themselves. It cannot be thought unusual for a bank customer to make and repay regularly many loans while its business flourishes, but to default on subsequent loans when its business founders.

their money because the accounts became uncollectable. Under Louisiana law, the bankers' blanket bond does not provide credit insurance. *See Allen State Bank v. Traveler's Indemnity Co.*, La.App.1972, 270 So.2d 270, 273. *See also First National Bank v. Aetna Casualty and Surety Co.*, 6 Cir. 1962, 309 F.2d 702, 705, *cert. denied*, 372 U.S. 953, 83 S.Ct. 951, 9 L.Ed.2d 977. As the Louisiana court said in *Allen State Bank*, "the bond is not a policy of credit insurance and does not protect the bank when it simply makes a bad business deal".

To the same effect are *East Gadsden Bank v. United States Fidelity and Guaranty Co.*, 5 Cir. 1969, 415 F.2d 357, 359-60 and *First National Bank and Trust Co. v. Continental Insurance Co.*, 10 Cir. 1975, 510 F.2d 7, 12-13. In *East Gadsden Bank*, we affirmed a decision of a district court holding that the loan exclusion clause applied to a transaction in which the borrower, who received funds on the security of construction contracts, misappropriated the payment of contract monies. We observed, "it is plain that the Insurer here did not purport to provide a policy of credit insurance". In *First National Bank*, the Tenth Circuit held that the purchase of commercial paper by a bank constituted a loan to the automobile dealership from which the paper was purchased. The court observed

> The important aspect of this case is the fact that for some ten years First National had been financing the . . . dealership by making countless loans, *in one form or another*. And when the . . . dealership folded, First National was left with unpaid loans. Such loss was an excluded risk.

(Emphasis added.)[15]

All that remains is to distinguish the instant transaction from the check-kiting cases.[16] The most important distinction is that, when the bank credits a check, it reasonably expects the check to be paid in the normal course of business. *See Pioneer Valley Savings*

15 Two other cases have held that the loan exclusion clause applies to the advance of money on the assignment of receivables evidenced by false invoices. *Exchange Nat'l Bank v. Insurance Co. of North America*, 2 Cir. 1965, 341 F.2d 673; *Capitol Bank v. Fidelity & Cas. Co.*, 7 Cir. 1969, 414 F.2d 986. These cases suggest that coverage depends, in part, upon the ease with which the bank could verify the lack of the accounts. This would not, of course, explain the result in the check-kiting cases, in which even a cursory attempt at verification would uncover the fraudulent scheme. There is no inconsistency, however, because the cases mentioned above were discussing the applicability of Clause E, which provides some exceptions to the loan exclusion in cases of counterfeiting and forgery. To the extent, however, that the cases deem the loan exclusion applicable in the first instance, they support the position reached in this appeal. To be sure, notes evidencing the loan were signed in these cases. But as we make clear in text, the absence of notes does not preclude us from observing the true nature of the transactions.

16 We also distinguish *Shoals Nat'l Bank v. Home Indem. Co.*, N.D.Ala.1974, 384 F.Supp. 49, *aff'd without opinion*, 515 F.2d 1182. There, the district court held that a broader loan exclusion — denying coverage for losses due to "any loan or transaction in the nature of, or amounting to, a loan" — did not apply to a loss resulting from the advance of money on negotiable sight drafts and checks supported by false invoices. The court relied on *Paulding, National Bank of Commerce, In re Grand Union, supra*, and on the rule that ambiguities are to be construed against the insurer, *see First Nat'l Bank v. Insurance Co. of North America*, 7 Cir. 1970, 424 F.2d 312, 317 (rule applies notwithstanding fact that bond was the result of joint effort of the American Bankers Association and the Surety Association of America). *Shoals* is distinguished on two grounds: first, the court believed that the loss occurred because the bank's bookkeeping department mistakenly believed that the depositor has money in its account; second, the bond would not have excluded coverage for a loan anyway, because of an exception for transactions within the offices of the insured. *See* 384 F.Supp. at 53, 55. Even in the absence of these distinguishing characteristics, *Shoals* would be unpersuasive authority. Our affirmance without opinion is insignificant.

Bank v. Indemnity Insurance Co., N.D. Iowa 1964, 225 F.Supp. 404, 411, *aff'd*, 8 Cir. 1965, 343 F.2d 634. Such an expectation may be reasonable even if the bank knows that there are no funds in the drawee bank to cover the check, because of the depositor's credit at the drawee bank or because of the practice of many banks to honor overdrafts. *See id.* But, with respect to the drafts deposited with the two banks here, there could have been no reasonable expectations. Although many previous drafts had been paid in the normal course of business, it was always up to the purchaser to honor or dishonor a draft. The difference between checks and drafts is well explained in E. Farnsworth, Commercial Paper 345 (1968):

> . . . [a collecting bank] will treat the draft as a "collection" item rather than a "cash" item. Checks, the most common items handled by the banks, are dealt with in bulk as "cash" items on the assumption that they will be honored in the overwhelming majority of cases; provisional credits are entered immediately for a check at all states of the collection process and automatically become final without further action upon payment by the drawee bank . . . documentary drafts, on the other hand, are handled as "collection" items and dealt with individually, rather than in the bulk, and since no assumption is made that they will be honored, no credits, not even provisional credits, are given until the item has been paid by the buyer.[17]

17 *Quoting* Farnsworth, *Documentary Drafts Under the Uniform Commercial Code*, 22 Bus. Law. 479, 482 (1967). Although Art. 4 of the U.C.C. was not in force in Louisiana at the time of the transactions with which we are concerned, Farnsworth's observations are

The banks here must have known that there was considerable risk in crediting the drafts before acceptance by the purchaser. The banks took such risks in the hope of making a profit on the interest or in obtaining other business advantages. The insurers, who did not issue a policy of credit insurance, did not take those risks and are not to be held accountable now, when the risks have turned bad.[18]

III

NSF CHECKS

The remaining issue is whether the Louisiana Bank suffered a loss when it paid off stale rough rice drafts after receiving NSF checks drawn on Lake's Calcasieu account and deposited in Rex's Louisiana Bank account. This issue turns, according to Louisiana Bank, on whether the bank was actually liable on the stale drafts. The bank suggests, in its reply brief and in its oral argument, that there is no evidence that the drafts were regular on their fact and, hence, that the bank was, under Louisiana law, actually liable on them. The district court impliedly found that a loss occurred from the deposit of the NSF checks. No mention is made, however, of the defendant's contention that the bank lost no money because it used funds to pay its

not legal observations but practical observations. In any event, there does not appear to be any relevant difference between the old Negotiable Instruments Law and the U.C.C.

18 We are confident that our construction of the bonds has not "trapped" the banks in the sense of their being victimized by a ruling that they could not have expected. *See Williams v. Union Central Life Ins. Co.*, 1934, 291 U.S. 170, 180, 54 S.Ct. 348, 78 L.Ed. 711; *Hemel v. State Farm Mut. Auto. Ins. Co.*, 1947, 211 La. 95, 29 So.2d 483, 486.

own debts. We hold that the implicit finding of the district court has no evidentiary support in the record.

The answer of the defendant to Louisiana Bank's complaint alleges that "no loss has been suffered by complainant by reason of the issuance of the checks described in the complaint". The pretrial stipulations bear out this allegation. The bank stipulated that: "drafts exemplified by Defendant's Exhibit 19 were drawn on Rex Rice account at Louisiana Bank . . ."; on March 17, 1969 "Louisiana Bank . . . paid $100,518.89 of Rex's outstanding stale drafts and shortly thereafter paid an additional $4,037.94 of stale Rex drafts"; Louisiana Bank records "show that Louisiana Bank . . . failed to accept or to make timely protest or non-acceptance of considerably more than $110,000.00 worth of Rex's rough rice drafts . . . and this made Louisiana Bank . . . liable to the payees on the payment of said drafts"; and "Louisiana Bank . . . did, in fact, accept or concede liability for at least $512,972.37 of similar stale drafts still remaining unpaid after March 17, 1969". Although there is no direct evidence that the drafts paid by Louisiana Bank with the proceeds of the NSF checks were regular on their faces, there is overwhelming indirect evidence to that effect. There is no suggestion in the record of any irregularity of such drafts. There is no suggestion that the exemplary draft, Defendant's Exhibit 19, is irregular. There is no reason to believe that Louisiana Bank, when faced with such a huge loss on stale rough rice drafts, would have paid off any drafts on which it was not liable.[19]

19 By way of suggesting that it might not have been liable on the drafts paid on March 17, 1969, Louisiana Bank cites *Bollich v. Louisiana Bank & Trust Co.*, 1972, La.App., 271 So.2d 274. There Loui-

The bank's attempt to prove a loss on the theory that it was not actually liable on the drafts that were paid is an attempt to accomplish what it failed to do, or could not do, at trial. Especially in view of the breadth of the pretrial stipulations, it was imperative for Louisiana Bank to produce the drafts it actually paid and to show that it was not liable on such drafts. We therefore hold that Louisiana Bank suffered no loss through its payment of the stale rough rice drafts.

In conclusion, we reverse the judgment in both district courts. The bonds did not cover any losses incurred by the plaintiff banks.

REVERSED.

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siana Bank was relieved of liability on a draft presented twice, on March 17 and March 19. Each time the draft was returned without payment within the 24-hour period. Even if this case supported, which it does not, the bank's contention that it might not have been liable on the drafts paid on March 17, the case does not appear to have been presented as evidence in the trial court.

APPENDIX C

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 75-1427

LOUISIANA BANK & TRUST CO.,
Plaintiff-Appellee,
Cross Appellant,

versus

THE EMPLOYERS LIABILITY ASSURANCE CORP.,
Defendant-Appellant
Cross Appellee.

Appeals from the United States District Court for the
Western District of Louisiana

ON PETITION FOR REHEARING

(JULY 12, 1976)

Before COLEMAN and GEE, Circuit Judges*.

PER CURIAM:

IT IS ORDERED that the petition for rehearing filed in the above entitled and numbered cause be and the same is hereby DENIED.

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* Judge Wisdom was a member of the original panel but because of illness did not participate in this decision.

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 74-3918

D. C. Docket No. CA-15534

CALCASIEU-MARINE NATIONAL
BANK OF LAKE CHARLES,
Plaintiff-Appellee,

versus

AMERICAN EMPLOYERS' INSURANCE CO.,
Defendant-Appellant.

Appeal from the United States District Court for the
Western District of Louisiana

Before WISDOM, COLEMAN and GEE, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Western District of Louisiana, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, reversed;

It is further ordered that plaintiff-appellee pay to defendant-appellant, the costs on appeal to be taxed by the Clerk of this Court.

June 14, 1976

Issued as Mandate: JUL. 20, 1976